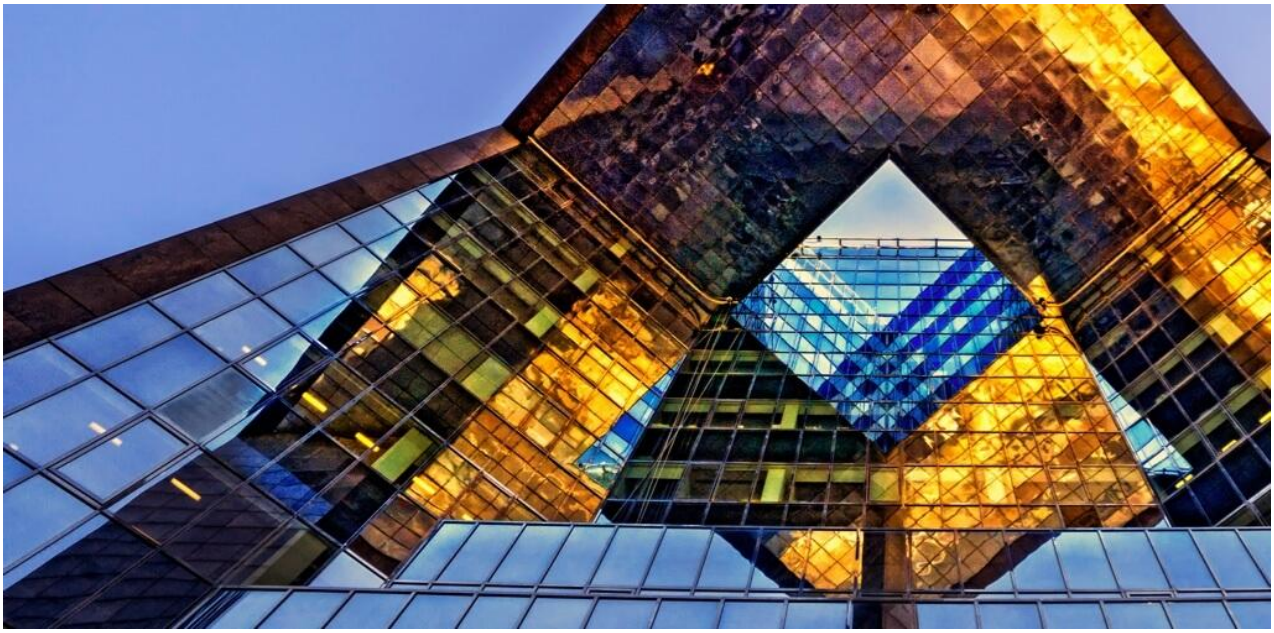
January 2023 market update

The Bank of Canada signals a pause on the horizon

Feb. 7, 2023



Introduction

January data revealed resiliency throughout major economies despite considerable economic uncertainty and tighter financial conditions. The U.S., Europe and China reported economic expansion in the fourth quarter of 2022, albeit at relatively slower levels. Inflation has been coming down but remains at stubbornly high levels, particularly in Europe and the U.K. The Bank of Canada ("BoC") raised its benchmark overnight interest rate by 25 basis points ("bps") to 4.50% in January while signalling its intention to pause interest rate hikes. Central banks in the U.S., Europe and the U.K. will make their first 2023 interest rate announcements in February.

Global equity markets advanced over January 2023 as economic results lifted expectations that the global economy might avoid a deep recession. In Canada, the S&P/TSX Composite Index posted a gain, led by the Information Technology sector. In the U.S., the S&P 500 Index finished higher, benefiting from the strong performance of the Consumer Discretionary sector. Yields on 10-year government bonds in Canada and the U.S. ticked lower over the month. Oil prices finished lower, while the price of gold advanced amid economic uncertainty.

BoC signals a pause to rate increases

At its first meeting of 2023, the BoC raised its benchmark overnight interest rate by 25 bps to 4.50%. Economists widely expected the 25-bps rate hike. It was the BoC's eighth straight rate increase and the lowest since it embarked on its aggressive monetary tightening path. While the slowdown in rate hikes is significant, BoC comments offered insight into the central bank's direction. Its updated Monetary Policy Report ("MPR") and associated comments suggest it might be time for a pause in its interest rate increases. In its MPR, the BoC projected inflation to remain elevated in the near term but might scale back quickly late this year. However, the tighter financial conditions brought on by high inflation and rate increases will likely weaken economic conditions in Canada. The BoC said its rate decisions would highly depend on how the economy progresses based on its projections. Investors interpreted the position as a signal that an interest rate pause would be likely. The BoC might implement an interest rate hold at its next meeting in March as it monitors how monetary policy actions affect inflation and the Canadian economy.

Expecting weak global economic growth in 2023

The World Bank expects global economic growth to slow considerably in 2023 in response to geopolitical tensions, rising interest rates, stubbornly high inflation and eroding consumer confidence. Waning global demand amid tighter financial conditions is sure to affect growth, as already evidenced in the global manufacturing sector, where new orders and exports fell over the last few months of 2022. But the World Bank does not believe a global recession is imminent. In its most recent economic outlook, the World Bank projects the global economy to expand by only 1.7% this year, which would mark the third slowest pace of expansion in the last thirty years, trailing 2009 and 2020. Weaker conditions in economic powerhouses, including the U.S., China and Europe, will hurt other economies around the world. The economic organization believes emerging markets economies could be particularly hard hit over the year. With interest rates rising quickly in developed economies and uncertainty among investors rising amid expectations of weakening global economic conditions, investment has flowed to developed nations, leaving emerging markets economies lacking foreign investment. And with lower global economic activity, emerging markets economies are expected to post weak economic growth.

Lunar New Year travel in China rebounds

Relaxed COVID-19 policies and the start of the Lunar New Year seemed to be a recipe to kickstart economic activity in China. Although COVID-19 remains a risk, domestic demand to visit tourist attractions surged during the national holiday, with spending rising markedly higher. For example, hotel bookings at the beginning of the holiday exceeded bookings during the same period before the pandemic in 2019. Meanwhile, movie box office sales in the first four days were 3.6 billion yuan (C$711 million), surpassing the 3.4 billion yuan achieved in 2019, before the pandemic. In addition, airline tickets rose by more than 400% year-over-year. With increased spending comes increased economic activity. The Lunar New Year consumption data suggests that pent-up consumer demand is being released, which could support economic activity.

Lower COVID-19 restrictions helped business activity in China. According to the NBS General Purchasing Managers Index, business activity in China expanded in January for the first time since September 2022, and at its fastest pace since June 2022. A rise in new orders aided manufacturing activity. Not to be outdone, China's service sector expanded at its sharpest pace since June 2021, also benefiting from a rise in new orders.

Business activity returns to expansion in Europe

According to a preliminary estimate from the S&P Global Eurozone Composite Purchasing Managers Index, business activity across Europe expanded in January. It was the first business activity expansion since June 2022. Despite so much economic uncertainty and ultra-tight financial conditions, business activity across Europe is showing some signs of stability. However, it was not evenly distributed across various sectors of the economy. The service sector was the key contributor to January's business growth. In particular, the technology and health care sectors were key drivers of that growth in the service sector. The sector benefited from sharper employment growth while new orders fell, but only at a very slow pace. Meanwhile, input cost pressures moderated in January, easing some financial pressure on service providers.

The manufacturing sector, however, remained in contraction territory, but the pace of contraction was the slowest since August. Business activity growth shows the economy remains relatively resilient despite much tighter financial conditions. According to a flash estimate, the European economy expanded by 0.1% in the fourth quarter, muting some concerns about a potential recession.

Market performance - as at Jan. 31, 2023

Equity Markets	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
S&P/TSX Composite Index C$	20,767.38	7.13%	**7.13%**	7.13%	**7.13%**	-1.57%	**-1.57%**
S&P 500 Index US$	4,076.60	6.18%	**4.54%**	6.18%	**4.54%**	-9.72%	**-5.28%**
Dow Jones Industrial Average US$	34,086.04	2.83%	**1.25%**	2.83%	**1.25%**	-2.98%	**1.79%**
MSCI EAFE Index US$	2,100.43	8.05%	**6.39%**	8.05%	**6.39%**	-5.49%	**-0.85%**
MSCI Emerging Markets Index US$	1,031.50	7.85%	**6.20%**	7.85%	**6.20%**	-14.63%	**-10.43%**
MSCI Europe Index US$	1,880.60	8.61%	**6.94%**	8.61%	**6.94%**	-5.81%	**-1.18%**
MSCI AC Asia Pacific Index US$	167.95	7.84%	**6.19%**	7.84%	**6.19%**	-9.07%	**-4.60%**

Fixed Income Markets	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
	1,083.63	3.09%	**3.09%**	3.09%	**3.09%**	-5.75%	**-5.75%**

FTSE Canada Universe Bond Index C$							
FTSE World Investment Grade Bond Index US$	209.01	3.36%	**1.77%**	3.36%	**1.77%**	-12.43%	**-8.08%**

Currencies	**Level**	**Month to date**	**Month to date (C$)**	**Year to date**	**Year to date (C$)**	**1 year**	**1 year (C$)**
CAD/USD	0.7515	1.25%	-	1.25%	-	-5.08%	-

Commodities	**Level**	**Month to date**	**Month to date (C$)**	**Year to date**	**Year to date (C$)**	**1 year**	**1 year (C$)**
West Texas Intermediate (US$/bbl)	78.87	-1.73%	-	-1.73%	-	-10.53%	-
Gold (US$/oz)	1,928.35	5.72%	-	5.72%	-	7.30%	-